

Law and Business Review of the Americas

Volume 12 | Number 2

Article 4

2006

Public-Private Partnerships: The Key to Sustainable Microfinancing

Alexandra O'Rourke

Follow this and additional works at: <https://scholar.smu.edu/lbra>

Recommended Citation

Alexandra O'Rourke, *Public-Private Partnerships: The Key to Sustainable Microfinancing*, 12 LAW & BUS. REV. AM. 179 (2006)
<https://scholar.smu.edu/lbra/vol12/iss2/4>

This Article is brought to you for free and open access by the Law Journals at SMU Scholar. It has been accepted for inclusion in Law and Business Review of the Americas by an authorized administrator of SMU Scholar. For more information, please visit <http://digitalrepository.smu.edu>.

PUBLIC-PRIVATE PARTNERSHIPS: THE KEY TO SUSTAINABLE MICROFINANCING

*Alexandra O'Rourke**

I. INTRODUCTION

WHEN the United Nations (U.N.) declared 2005 the International Year of Microcredit, its main goals were to promote integrating microfinance into the international financial sector, to help sustain microfinance efforts, and to encourage innovation and strategic partnerships to expand microcredit's scope and reach around the world.¹ The efforts of the U.N. are especially important because only about 1 percent of the world's 7000 microfinancing institutions (MFI) are currently considered financially stable.² This paper explores legal barriers to the sustainability of MFIs and argues that the international development community should promote formal partnerships between commercial banks and MFIs. Creating structured partnerships between commercial lending institutions and MFIs would provide the best long-term sustainability results and would allow MFIs to flourish as independent and vital parts of developing world financial systems, without threatening the security and stability of the financial systems supporting these innovations.

Microfinancing is a vital tool for development in that it enables the poor to build assets, increase income, and reach self-sufficiency. Additionally, microcredit encourages entrepreneurship and innovation in rural and consumer goods sectors, which help grow and strengthen developing countries' economies. Microcredit also moves small businesses from the informal to the formal sectors, which increases stability and security and broadens the tax base. MFIs fill a unique role in the financial system: they provide capital for borrowers who would otherwise be priced out of

* Alexandra Villarreal O'Rourke is a third year J.D. candidate at Harvard Law School. She has a degree in Finance from the University of Texas and an L.L.M. in international law from Queen's University in Belfast. Ms. O'Rourke has worked in international finance and aid projects with the U.S. Department of State's Bureau of Migration, Population, and Refugees and with the United Nation's Development Program in Bogotá, Colombia. She is currently conducting immigration-related research in Mexico through Harvard's Fredrick Sheldon Traveling Fellowship.

1. International Year of Microcredit, 2005, G.A. Res. 53/197, 53d Sess., U.N. Doc. A/RES/53/197 (Feb. 22, 1999), *available at* <http://documents.un.org/mother.asp>.
2. INTERNATIONAL MONETARY FUND, MICROFINANCE: A VIEW FROM THE FUND, 7 (2005), <http://www.imf.org/External/np/pp/eng/2005/012505.pdf>.

the financial market, due to the high transaction costs associated with very small loans as well as the high-risk nature of the smallest enterprises.

In the 1980s and 1990s, MFIs flourished as research and experience began to show that MFI clients had excellent repayment histories and could produce sufficiently high interest margins to sustain the institutions.³ By the mid-1990s, over 900 institutions in more than 100 nations provided approximately US \$7 billion to over 14 million micro-entrepreneurs.⁴

Governments and international organizations, having once sponsored the bulk of MFIs, began seeking ways to foster self-sustainability and independence among the institutions in order to eliminate the dependency of state and non-governmental organization (NGO) funding. As governments pursued this development, legal barriers emerged that highlighted some of the obstacles that could prevent MFIs from reaching full sustainability.

Part II of this paper provides a brief background on the microfinancing movement, including the goals of microfinancing, the types of institutions, and the historical shifts in the international approaches to MFIs. Part III provides an analysis of some of the main legal barriers to MFI sustainability, including minimum capital requirements, loss-prevention regulation, limits on the savings and lending capabilities of MFIs, and regulatory barriers that prevent the conversion of MFIs into banking institutions.

Part IV analyzes existing legislative and structural alternatives designed to overcome those barriers that have been developed around the world, such as lower capital requirements for MFIs, adjusted loss-prevention requirements, reliance on commercial loans or securities issuances for fundraising, and the creation of partnerships with private commercial lending institutions. This section argues that the latter alternative surpasses the others in its ability to create a permanent solution to MFI sustainability problems. Part V discusses the potential mid- and long-term effects of the proposed recommendation on both the MFI system and on the financial industry in general.

II. BACKGROUND ON MFIS AND THEIR REGULATION

A. THE ORIGINS OF THE MICROFINANCING MOVEMENT

This Part sets the background for analysis by exploring the basis of the microfinancing movement and describing the main characteristics of the most common MFIs. In many regions of the developing world, particularly in rural areas, small informal businesses constitute a vital pillar of the local economies, providing jobs and income for some of the world's

3. *The History of Microfinance*, GLOBAL ENVISION Apr. 14, 2006, <http://www.globalenvision.org/library/4/1051/> (last visited Sept. 11, 2006).

4. WARNER WOODWORTH ET AL., *SMALL REALLY IS BEAUTIFUL: MICRO APPROACHES TO THIRD WORLD DEVELOPMENT* 19 (1997).

poorest economies. These small enterprises—including farming operations, family businesses, or artesian cooperatives—have many of the same financial needs as large companies, such as: cash flow management, risk prevention, asset building, consumption stabilization, and consumer credit provisions.⁵ The difference between microbusinesses and regular businesses is that, due to the small size of their financial needs, the transaction costs associated with financing often make it unprofitable for normal financial institutions to service them. In addition, the capital requirement and minimum regulatory standards, established in most countries to foster the security and stability of the banking system, often leave small businesses out of the market altogether. Most importantly, however, the high risk and small return inherent in the nature of small less formal businesses often do not fit the interest and risk profiles of banks and other financial institutions, which see these efforts as not profitable enough to merit the high uncertainty.⁶

Due to the lack of accessibility to formal avenues of financing, microenterprises have traditionally been supported mostly by informal institutions that have been around for hundreds of years in the developing world.⁷ The informal bodies range from community savings groups and lending circles to unofficial high-interest moneylenders and supplier credit lines.⁸ They provide starting and operational capital for the smallest businesses. But the informality of these lending alternatives presents important drawbacks. First, because lending circles and community partnerships often have rigid lending cycles and strict amounts, they lack the flexibility and robustness needed to account for fluctuation in funding needs.⁹ In addition, reliance on informal money lenders and credit-line providers often creates power dynamics that result in excessive interest rates and continuous dependency.¹⁰ These obstacles significantly limit the scope and growth of the businesses that depend on the informal lenders.

The modern wave of MFIs began during the 1950s when development projects first introduced subsidized credit programs that focused on rural efforts.¹¹ The true emergence of the modern microfinancing age, how-

5. See, e.g., MAKING FINANCIAL MARKETS WORK FOR THE POOR: GUIDELINES ON MICROFINANCE (Swedish International Development Cooperation Agency Oct. 2004), available at http://www.sida.se/shared/jsp/download.jsp?f=SIDA4254en_GuidelinesMF_web.pdf&a=3321#search=%22microfinance%20%20%22cash%20flow%20management%22%20%22asset%20building%22%20%22consumer%20credit%22%22 (last visited Sept. 11, 2006).

6. TOR JASSON & MARK WENNER, FINANCIAL REGULATION AND ITS SIGNIFICANCE FOR MICROFINANCE IN LATIN AMERICA AND THE CARIBBEAN (Dec. 1997), available at <http://www.gdrc.org/icm/govern/iadb-jansson.pdf#search=%22microfinance%20risk%20profile%20%22traditional%20financial%20institutions%22%22> (last visited Sept. 11, 2006).

7. *History of Microfinance*, *supra* note 3.

8. *About Microfinance: Overview*, CONSULTATIVE GROUP TO AID THE POOR 2003, <http://www.cgap.org/about/microfinance.html> (last visited Sept. 11, 2006).

9. *Id.*

10. *Id.*

11. *Id.*

ever, occurred during the 1970s and 1980s with the birth of microenterprise lending programs, which focused mostly on poverty alleviation efforts that targeted the very poor and were often supplemented by forced saving programs.¹² The main efforts were undertaken by non-governmental organizations such as the flagship Grameen Bank for the Poor that focused on microfinancing as development aid.¹³ Throughout the 1990s microfinancing continued to gain force as one of the key tools of development. In addition to the emergence of international coalitions focused on microfinancing such as the world-wide Microcredit Summit Campaign¹⁴ and the Consultative Group to Assist the Poor,¹⁵ the world's largest development organizations, including the World Bank, the U.N. Capital Development Fund, and the European Bank for Reconstruction and Development, have created full-scale movements to promote the availability of microfinancing and create innovative microcredit alternatives. This international movement is evidenced by the establishment of the U.N.'s International Year of Microcredit in 2005, during which member states have created new initiatives to foster innovation and development of MFIs through regulatory changes and partnerships with the private sector.¹⁶ But the new initiatives face the unique nature and challenges of MFIs and must create alternatives to fit those characteristics into a sustainable model.

B. TYPES OF MICROLENDING INSTITUTIONS (MLIs)

An accumulating savings and credit association is one example of an MFI. MFI applies to any formal organization whose primary activity is microfinance, ranging from credit unions to public funds fully sponsored by local governments.¹⁷ MFIs can range from informal community initiatives, to cooperative organizations, to more traditional lending institutions. The Accumulation Savings and Credit Association is one example of an MFI.¹⁸ All of its members save the same fixed amount regularly

-
12. Gord Cunningham, *Microfinance: Flavour of the Month or Practical Development Alternative?*, Conference Presentation at the Yukon Economic Forum: Ideas Summit (Mar. 25, 2000), available at http://www.coady.stfx.ca/resources/publications/publications_presentations_microfinance.html.); See *History of Microfinance*, *supra* note 3.
 13. *A Short History of Grameen Bank*, GRAMEEN BANKING FOR THE POOR 1998, <http://www.grameen-info.org/bank/hist.html> (last visited Sept. 11, 2006).
 14. MARGUERITE S. ROBINSON, *THE MICROFINANCE REVOLUTION* 25 (2001).
 15. About the Consultative Group to Aid the Poor, <http://www.cgap.org> (last visited Sept. 9, 2005).
 16. *Who's Involved—National Committees*, INTERNATIONAL YEAR OF MICROCREDIT 2005, http://www.yearofmicrocredit.org/pages/whosinvolved/whosinvolved_nationalcommittees.asp (last visited Sept. 11, 2006).
 17. Basics of Regulation: Glossary, Consultative Group to Aid the Poor, http://microfinancegateway.org/resource_centers/reg_sup/basics/glossary (last visited Sept. 11, 2006).
 18. CGAP Savings Information Resource Center, Consultative Group to Aid the Poor, http://www.microfinancegateway.org/resource_centers/savings/ (last visited Sept. 11, 2006).

and can borrow from the group at an interest charge.¹⁹ The interest return is then distributed among the group.²⁰ Postal Savings Banks are more traditional examples of MFIs. They operate much like regular banks, but they tend to serve mostly rural communities through local postal offices and offer more flexible terms than commercial banks.²¹ While MFIs vary significantly in nature and scope, MLIs are the most common type of MFI. MLIs consist mostly of non-profit organizations that focus only on providing credit and often receive support from the government or international organizations.²² The main focus of MLIs is to provide loans to clients that cannot access the formal banking system. Most MLI beneficiaries are rural entrepreneurs and people working in the informal economy.²³ The loans usually range from single-digit dollar amounts to approximately US \$1,000 and often do not require collateral or credit checks.²⁴ While some MLIs, such as Bolivia's BancoSol and Mexico's Compartamos have begun to seek private investors,²⁵ most depend solely on grants from governments, international development banks, and donors.²⁶ Dependency on grant funding is the main factor that limits the ability of MLIs to reach self-sufficiency. This challenge of self-sufficiency has become the recent focus of the microfinancing movement.

III. LEGAL BARRIERS TO THE SUSTAINABILITY OF MFIS

This section discusses the most important and common legal barriers that prevent MFI sustainability and self-sufficiency. MFIs are often unsustainable and not self-sufficient because they cannot self-fund by accepting client deposits. This problem, in turn, is mostly due to the inability of MFIs to comply with minimum capital requirements and other regulatory measures, such as targeting and loss prevention. The other significant factor that stands between MFIs and long-term sustainability is the many legal barriers that prevent MFIs from transforming into formal banking institutions when they have the ability to operate as such. This section explores those two main barriers to sustainability and provides the background for discussion of the types of legal and regulatory changes that would foster MFI growth and success.

19. *Id.*

20. SAVINGS SERVICES FOR THE POOR: AN OPERATIONAL GUIDE (Madeline Hirschland, ed., 2005).

21. *Id.*

22. ANDREY GIDASPOV, THE U.S. RUSSIA CTR. FOR ENTREPRENEURSHIP, CURRENT TRENDS IN THE RUSSIAN MICROFINANCE SECTOR (2002), <http://www.cfe.ru/eng/center/?aid=35>.

23. Eduardo Kaplan, *Background: Microlending*, INITIATIVE FOR POLICY DIALOGUE, http://www2.gsb.columbia.edu/ipd/j_microlending.html (last visited Sept. 11, 2006).

24. *Id.*

25. *Id.*

26. *Id.*

A. MINIMUM CAPITAL REQUIREMENTS

One of the main legal barriers to the profitability and sustainability of MFIs is the requirement, present in most countries' regulatory structures, of a fixed amount of minimum starting capital in order to perform certain financial services, such as taking consumer deposits. A state sets high capital requirements to ensure the stability of the state's financial system by allowing only those institutions that have enough capital to endure fluctuations in the market and survive unforeseen challenges to enter the market.²⁷ High capital requirements are also intended to prevent the over fragmentation of the banking system, which could lead to regulatory challenges.²⁸ Currently the trend towards further tightening capital requirements has swept a number of European central banks, particularly in Eastern European countries such as Moldova and Romania.²⁹ This trend may be due to the fact that, as Eastern European countries prepare for potential entry into the European Union, they have begun to focus on the stabilization of their markets, even at the expense of development efforts such as microfinancing.

While capital requirements serve an important purpose—one highlighted by numerous international financial agreements, such as the Basel Principles³⁰—they create a strong impediment to the development of MFIs. The reason is that they require disproportionately large investments for small-scale projects in the risky environments in which MFIs operate. Evidence has shown that high capital requirements greatly hinder microfinancing efforts. For example, the U.N. Capital Development Fund Project in the Kyrgyz Republic found that one of the main factors preventing the development of MFIs in that country was its strict 20 percent reserve requirement.³¹ In addition, minimum capital requirements make the fundraising effort quite difficult for MFIs, since investors increasingly require MFIs to contribute approximately 10 percent of the required capital.³² When minimum capital requirements reach as high as US \$5 million, as they do in many countries, few MFIs have the capital and infrastructure to make such a substantial investment.³³ The chilling effect of high capital requirements on MFIs is so clear that at least one country has begun to strategically tighten its requirements in order to

27. Charlotte Gray et al., *Sustainability of Microfinance Banks: The Ultimate Goal*, 8 *LAW IN TRANSITION*, Nov. 23, 2003, <http://www.ebrd.com/pubs/legal/OL03c.pdf#search=%22Charlotte%20Gray%20%20Sustainability%20of%20Microfinance%20Banks%3A%20the%20Ultimate%20Goal%20v%2C%22> (last visited Sep. 11, 2006).

28. *Id.*

29. *Id.*

30. *Id.*

31. KYRGYZ REPUBLIC UNDP MICROFINANCE PROJECT DOCUMENT (1999), http://www.uncdf.org/english/microfinance/documents_and_reports/country_feasibility/kyrgyzdb.php.

32. *Id.*

33. HOW TO REGULATE AND SUPERVISE MICROFINANCE? - KEY ISSUES IN AN INTERNATIONAL PERSPECTIVE (Alfred Hannig & Edward Katimbo-Mugwanya eds., 2000), available at <http://www.microfinancegateway.org/content/article/detail/2661>.

raise entry barriers on MFIs and drive smaller MFIs out of business. In 1999, Indonesia introduced capital requirements as part of a policy to foster fewer and larger MFIs.³⁴

B. INTEREST RATE CAPS

Another important barrier to the profitability and independent survival of MFIs is the establishment of blanket interest rate caps that fail to consider the disproportionately high transaction costs and risky environments in which MFIs operate. Many countries have implemented ceilings on the allowable interest rate charges for loans that are designed to prevent predatory lending and abuse of power on behalf of financial institutions.³⁵ Because these interest rate limits usually take into consideration the main stream banking system, of which the MFIs are not a part of, they are based on estimates of appropriate transaction costs, returns, and risk premiums that apply to the commercial banking industry, but not to MFIs. MFI transaction costs, for example, tend to be proportionately much higher than their commercial counterparts, due to the small size of their loans that nonetheless require most of the same administrative and management expenses as regular loans. Therefore, in order to be profitable, MFIs require a higher interest rate that covers their costs and adjusts for the unique environment in which they operate.

Another reason why MFIs require higher interest rates is because MFIs lend to the poorest of entrepreneurs without safeguards such as collateral or credit ratings, their risk ratios are much higher, and they need higher interest rates to make up for their potential losses. Several illustrations of the negative effects of low interest rate caps on MFI performance have emerged in the last few years. For example, in Nicaragua, the Association of Nicaraguan MFIs reported that their members' portfolios fell from 30 percent to less than 2 percent after the government introduced an interest rate ceiling in 2001.³⁶ In West Africa the introduction of a 27 percent interest rate cap has led to the divestment of MFIs from rural areas to areas where it is cheaper to sell and that have increased loan minimums.³⁷ Today approximately forty developing countries have interest rate ceilings that limit the ability of microlenders to grow at natural rates and force them to keep their rates down by increasing the size of their loans and rejecting risky investors, thereby excluding the very audience they are designed to target.³⁸

34. HAMID RUSTAMOV, BETTER PRACTICES FOR SCALING-UP RURAL MICROFINANCE IN TAJIKISTAN (2004), <http://www.policy.hu/rustamov/Interim%20activity%20report.pdf>.

35. Brigit Helms & Xavier Reille, *Interest Rate Ceilings and Microfinance: The Story So Far*, CGAP OCCASIONAL PAPER, No. 9, Sept. 2004, available at <http://www.microfinancegateway.org/files/21796-10.pdf>.

36. Ann Duval, *The Impact of Interest Rate Ceilings on Microfinance*, CGAP DONOR BRIEF, May 2004, http://www.microfinancegateway.org/files/21628_53.pdf.

37. *Id.*

38. *Id.*

While the annualized percentage rates (APR) of MFIs, on average, tend to be more than twice those of commercial banks, they are also approximately a tenth of the rates charged by their counterparts in the informal market. For example, in Bangladesh, the commercial APR is between 10 and 13 percent, the MFI APR is approximately 20 to 35 percent, and the informal sources APR is approximately 180 to 240 percent.³⁹ This example shows that while MFIs have to charge higher interest rates on average, they are significantly preferable to the rates charged in the informal market. In this sense, the establishment of interest rate ceilings actually harms the poorest borrowers by leaving them out of the MFI market and forcing them into predatory lending outfits. The data also shows that interest rate ceilings have a significant impact in the market penetration of MFIs. A study of twenty-three countries, some with ceilings and some without, found that those countries with MFI ceilings had a market penetration rate of approximately 4.6 percent while countries without ceilings had a penetration of approximately 20.2 percent.⁴⁰ Therefore, it is clear that the effect of interest rate caps of MFI performance is not only to force them to stop serving the poorest clients, but also to greatly limit their scope and growth.

IV. POTENTIAL ALTERNATIVES TO ADDRESS THE LEGAL BARRIERS TO SUSTAINABILITY

It is clear that in order to overcome the obstacles to sustainability mentioned in the previous section, countries must implement initiatives that will foster the self-sufficiency of MFIs and will provide the right environment for their expansion and success. There have been countless proposed alternatives offered by the international development community to address this problem. But two potential solutions have earned the most attention and discussion and this paper shall focus on those. The first proposed alternative involved the creation of regulatory windows that allow regulatory agencies to apply lower capital and risk prevention standards to MFIs.⁴¹ But this paper will argue that it is a different alternative that best addresses the current barriers in a swift and timely manner and is most likely to provide a long-term solution to the legal barriers mentioned. This alternative involves the creation and encouragement of official MFI partnerships with commercial banks in order to benefit from their capital base and security measured while still being able to reach poor borrowers and savers. In order to explore the merits of this solution, this paper shall first carefully explore the arguments for and against the other proposals and ultimately compare those to the one suggested.

39. *Id.*

40. Helms & Reille, *supra* note 35.

41. Robert Peck Christen & Richard Rosenberg, *The Rush to Regulate: Legal Frameworks for Microfinance*, CGAP OCCASIONAL PAPER, No. 4, April 2000, at 1, available at http://www.cgap.org/docs/OccasionalPaper_04.pdf.

A. REGULATORY WINDOWS

The argument for the creation of a regulatory window that allows for lower minimum capital requirements and higher allowed interest rates for MFIs, centers around the fact that MFIs are meeting a need unmet by the commercial banks and should be given regulatory support through less strict requirements.⁴² The first premise of the argument is that MFIs are the only groups that are truly reaching the poorest clientele, a group that has been completely left out of the formal banking system as it currently exists. But these organizations often have to depend on grants and donations since they are unable, by law, to take deposits from their clients.⁴³ The reason for this is that the capital and risk measures contained in the licensing requirements they must meet in most countries, in order to begin accepting savings deposits, are unreasonably high considering the nature and scope of MFIs and are therefore unachievable targets.⁴⁴ According to this argument, therefore, the best solution would be to create a separate regulatory category for MFIs that contains more realistic (namely lower) standards that take into account the limited resources and unique roles of these institutions.⁴⁵ This new category would allow for the issuance of financial licenses (government certificates attesting to the financial soundness of an institution and permitting it to take deposits) to MFIs that formerly could not meet the licensing standards.

The goal of this approach would be to allow MFIs to gain self-sustainability by self-funding through deposits and encourage the entry into the market of new MFI organizations attracted by the stability of a licensing system.⁴⁶ The first argument is that licensing guidelines would cause existing MFIs to self-regulate and focus their efforts by setting new performance targets guided by the licensing requirements.⁴⁷ This may also result in the formation of partnerships or mergers between MFIs in order to reach those targets, leading to the combination of resources, experience, and expertise of several institutions. The second part of the argument suggests that the MFI licensing regime would attract the entry into the MFI market of organizations that previously had been dissuaded by lack of funding possibilities and the risks associated with a purely unregulated system.⁴⁸ This new licensing system would have the added value of allowing for the formal regulation of MFIs, thereby better protecting the interest of MFI clients and preventing some of the problems that plague some MFIs such as exorbitant interest rates and unstable capital bases.⁴⁹

This argument has already gained significant popularity in a number of countries which have responded by implementing entire systems of regu-

42. *Id.*

43. *Id.* at 12.

44. *Id.*

45. *Id.*

46. *Id.* at 13.

47. Christen & Rosenberg, *supra* note 41.

48. *Id.*

49. *Id.*

latory requirements designed exclusively to foster the creation and success of MFIs. One of the countries that has been most successful in implementing such measures is the Philippines. Through the General Banking Law of 2000⁵⁰ and supplemented by the Circular 273,⁵¹ the Philippines permitted MFIs to convert into thrift banks or rural banks, which are low regulatory requirement banks that focus on serving the poor, in order to allow for the creation of banks focused specifically on microfinancing efforts. In addition, they adapted the regulatory requirements of these new banks to fit the microfinancing model, allowing for starting capital requirements as low as US \$93,000.⁵² The General Banking Law specifically mentioned the special needs of MFIs as the source of the new measures stating, "the Monetary Board shall recognize the peculiar characteristics of microfinancing, such as cash flow-based lending to the basic sectors that are not covered by traditional collateral."⁵³ The General Banking Law and subsequent Circular allowed for MFIs to be subject to much lower capital minimums and other regulatory requirements while giving them official license to take deposits and utilize them as their main source of funding.⁵⁴ The Philippines has already seen easy success stories such as the Opportunity Microfinance Bank (OMB), the first non-collateral microfinance bank established in 2001 through a merger of five non-governmental organizations. By 2002, the OMB was serving 19,000 with a lending portfolio of US \$1.05 million and deposits of US \$542,000.⁵⁵ The Philippines is seen as one of the most compelling pieces of evidence supporting the introduction of licensing windows to fit the need of microfinance banks.

But while licensing windows may allow for the self-sufficiency of some MFIs there are significant drawbacks to their introduction that should be carefully considered. First, the elimination of interest rates limits will be a difficult political battle in the countries that currently have them.⁵⁶ This is so because the public often does not understand the counter-intuitive idea that higher interest rates could actually benefit rather than harm microborrowers in the long run by giving them access to some formal lending rather than forcing them into the much higher rates of the informal market.⁵⁷ In addition, the financial industry lobby will likely oppose

50. An Act Providing for the Regulation of the Organization and Operations of Banks, Quasi-Banks, Trust Entities and for Other Purposes, Rep. Act No. 8791, § 3 (2000), available at http://www.bsp.gov.ph/regulations/gbl2000/gbl2000_a.htm [hereinafter General Banking Law of 2000].

51. Circular No. 273, Series of 2001, § 1 (2001), available at http://www.bsp.gov.ph/Archive/Regulations_2001/Circulars/circular273.htm.

52. *Id.* § 1(3).

53. General Banking Law of 2000, *supra* note 50, § 40.

54. Circular No. 273, *supra* note 51, § 3.

55. *Opportunity Microfinance Bank Celebrates its First Anniversary*, ADB FINANCE FOR THE POOR (A Quarterly Newsletter of the Focal Point for Microfinance), Sept. 2002, Vol. 3, No. 3, at 8, available at http://www.adb.org/Documents/Periodicals/Microfinance/finance_200233.pdf.

56. See Christen & Rosenberg, *supra* note 41, at 7.

57. *Id.*

special interest rate exceptions for MFIs that will make their rates less competitive in comparison, even if they are targeting different audiences. In developing countries where a majority of borrowers tend to be small in size, the competition between formal institutions and MFIs may not be as distant as one might imagine. But even if the government manages to successfully eliminate interest rates for MFIs, another potential drawback is that a combination of the introduction of a licensing system with a lower minimum capital requirement and higher allowable interest rates could lead to undesirable harms to MFI customers. For example, if, as is argued above, the implementation of performance targets that will allow an MFI to gain a license will lead them to tighten their operations, this will likely mean that they will either be forced to increase the size and lower the risk of their loans, or charge much higher interest rates. If the first scenario occurs, it would create one of the very problems that the regulation window is design to avoid, namely it will leave the smallest and riskiest borrowers out of the MFI market and force them back into the informal sector. If the latter alternative is pursued, it could result in the emergence of artificially higher interest rates that would not only harm the MFIs existing clients, but could also result in unsustainable operations that will be difficult to uphold once the license is granted. In essence, the tightening of MFI operations to comply with licensing requirements, however relaxed they may be compared to the existing standards, could still result in pricing out the neediest borrowers, or creating unsustainable rates that might then lead to instability and possible default once the license is granted and the rates return to equilibrium levels.

Another important drawback is the potential burden on the regulatory authorities that would arise from the proliferation of new small banking institutions that are difficult to regulate. This proliferation could overburden the regulating authorities and threaten the stability of the country's banking system. This scenario is worsened by the fact that the smaller the institution, the less formal its processes, the harder it will be to supervise, and the more administrative resources it will occupy for monitoring and regulation. An example of this potential drawback occurred in the Philippines where the proliferation of small rural banks resulted in these small banks representing 83 percent of the banks the regulatory agency had to supervise while accounting for only 2 percent of the nation's deposits.⁵⁸ The ineffective regulation that could result from an overburdening of the regulatory authorities and increased complexity of regulation arising from less formal banks could create dangerous results for the future of MFIs. For example, the poor regulation and over-expansion of MFIs that are not ripe for self-sufficiency, but take advantage of the regulatory window, could result in the threat of defaulting MFIs, which would chill investor confidence and possibly hinder further growth.⁵⁹ In addition, poorly regulated deposit institutions could

58. Duval, *supra* note 36, at 5.

59. Christen & Rosenberg, *supra* note 41, at 15.

weaken the confidence of borrowers and depositors, threatening the stability of the MFI system as a whole.⁶⁰ A potential outcome would be that premature licensing of MFIs that are not ready for sustainability and regulation could send negative signals about the MFI market in general, stunting the growth of this emerging industry. A better way to approach the licensing question would be to find a way to foster increased profitability and sustainability of MFIs and faze them into the licensing system rather than establishing a blanket of weaker guidelines that could lead to the corruption of the market. One effective way of preparing MFIs for sustainability and ripeness for regulation would be to create partnerships between established commercial banks and existing and new MFIs, allowing the MFIs to benefit from the economies of scale, stability, and risk management of the larger institutions while still being able to reach their target microloan clients.⁶¹ The next section will explore the benefits and downsides of such an alternative.

B. PARTNERSHIPS BETWEEN COMMERCIAL BANKS AND MFIs

One way for MFIs to achieve self-sufficiency is for them to partner with commercial banks that can use their increased capital, lower transaction costs, better risk profiles, and larger, more profitable deposit investment alternatives to give the MFIs the starting capital and low administrative costs they need in order to reach long-term profitability.⁶² The capital and stability provided by these partnerships would allow MFIs to eventually meet the capital requirements and interest rate levels needed to earn independent banking licenses, and with them, the ability to take deposits as a way to reach self-sustenance. Alternatively, these partnerships can be a permanent relationship through which the MFIs can focus on expanding their reach, scope, and range of services. The commercial banks can also stand to greatly benefit from these partnerships by reaching new previously untapped markets of small borrowers, hedging their risk through the less volatile microloan market, and utilizing the expertise and unique practices of experienced MFIs. This section will explore the benefits of such partnerships to MFIs and commercial banks and will then explore ways to address some of the potential downsides that could arise from this arrangement.

There are three main benefits of the partnership approach in comparison to the regulation window approach mentioned above: greater stability and profitability from increased access to capital, lower transaction costs leading to lower interest rates, and better client reach and provision of service through the application of advances in technology used by commercial banks. The first benefit arises from the fact that a partnership will give MFIs a stable and robust source of capital that will allow them to gradually increase their stability and growth. It would also allow for in-

60. *Id.*

61. *Id.* at 18.

62. *Id.*

creased profitability through the bank's larger and higher-return deposit-investment alternatives, thereby increasing the MFIs profitability. An illustration of the potential benefits derived from such a system is the Sun-Link bank linkage model pioneered by the NGO Pride Africa.⁶³ Through this system, a commercial bank provides financial backing and a line of credit that allows MFIs to meet the requirements for a banking license.⁶⁴ MFIs then accept deposits from clients and manage the aggregation of deposits that is then invested into the commercial bank.⁶⁵ The bank is then able to invest these aggregate deposits more profitably than would the MFI itself since it has larger, more profitable investment opportunities and higher margins due to its aggregate capital.⁶⁶ This allows the commercial bank to serve a downstream market without having to manage the transaction costs of multiple depositors.⁶⁷ The risk is thereby absorbed between the two entities, allowing for more profitability.⁶⁸ In this way, the provision of capital not only benefits the MFIs through increased stability and profitability, but also provides commercial banks with alternatives for growing their market reach.⁶⁹

A second significant benefit is that the diminished transaction costs associated with the more advanced and efficient operation systems of commercial banks would allow the MFI to lower its interest charges, which would address the problem of interest rate ceilings that currently limit the success of MFIs. A partner commercial bank provides banking overhead services that lower the MFIs transaction costs and are less costly to the bank, due to economies of scale. One example of the potential for lowering transaction costs through private partnerships is the recent agreement between Visa International and the Foundation for International Community Assistance (FINCA). Visa will provide all its electronic loan payment and deposit management services for FINCA to manage its clients' accounts.⁷⁰ The system will allow FINCA to process loans automatically, minimizing loan transaction times and lowering transaction costs.⁷¹ In addition, Visa's industry-leading transaction security system will prevent mismanagement and provide borrowers more secure access to their loan capital.⁷² This increased security will also lead to lower capital leakage through system deficiencies that will further lower transaction costs, al-

63. Pride Africa, *Banking on Africa - Commercial Bank Linkages with Microfinance Institutions*, ITDG PUBLISHING (ALTERNATIVE FINANCE: MICROFINANCE ARTICLE LIBRARY) (2002), <http://www.alternative-finance.org.uk/cgi-bin/summary.pl?id=148>.

64. *Id.*

65. Gray et al., *supra* note 27.

66. *Id.*

67. *Id.*

68. *Id.*

69. *Id.*

70. News Releases, USAID, FINCA International and Visa Announce Microfinance Partnership: Partnership Targets Next Generation of Microfinance, (Jan. 24, 2004), <http://www.corporate.visa.com/md/nr/press210.jsp>.

71. Gray et al., *supra* note 27.

72. *Id.*

lowing the MFI to charge lower interest rates. The Visa/FINCA partnership is a model for the ways that MFIs can leverage the operational resources of commercial institutions to lower their transaction costs and provide lower-cost capital to their clients.

The third category of benefits that would arise from these partnerships extends beyond overcoming interest and capital regulatory requirements as barriers to sustainability. The technology advanced by the larger, more profitable commercial banks will allow MFIs to expand their reach and scope to encompass communities that are currently underserved in the microcredit market. For example, the robust computerized record system and account maintenance processes established by commercial banks will allow MFIs to more efficiently manage and supervise their clients' accounts in order to maximize reliability, timely reporting, and accountability. These improvements will not only allow MFIs to maximize the utilization rate of their funds, but will also prevent the capital leakage and resource waste that is common to poorly managed MFIs. One illustration of the benefits of using the technological advances of commercial banks to improve MFI services is that of Banrural in Guatemala. Banrural has introduced new pocket computer systems that have allowed microlenders to reach remote, practically inaccessible communities in the most rural areas of Guatemala.⁷³ It has also introduced digital fingerprinting technologies that have provided microlenders with an opportunity to circumvent the illiteracy barrier to the formal lending process.⁷⁴ Another example is the ICICI bank in India that has formed partnerships with numerous MFIs around the country.⁷⁵ ICICI is building a network of thousands of village internet kiosks that will deliver banking services throughout rural India.⁷⁶ These examples are some of the many ways that the high-tech operation systems used by commercial banks will allow MFI partners to expand their lending ability and scope to include the most underserved and isolated microentrepreneurs.

Partnerships would also benefit the commercial banks in three main ways. First, partnering with MFIs would allow them to reach a new market and benefit from the MFIs' expertise and aggregating operations so that the bank can mitigate the high transaction costs associated with small loans and the learning curve of the new business. The SunLink model mentioned above is an illustration of this benefit.⁷⁷ Through it, the MFI collects small deposits into client groups that it then transfers to the commercial bank as single accounts.⁷⁸ This allows the commercial bank to serve a downstream market without having to manage the transaction

73. Elizabeth Littlefield & Richard Rosenberg, *Microfinance and the Poor: Breaking Down the Walls between Microfinance and Formal Finance*, *FINANCE & DEVELOPMENT*, June 2004, Vol. 41, No. 2, at 38, 40, available at <http://www.imf.org/external/pubs/ft/fandd/2004/06/index.htm>.

74. *Id.*

75. *Id.*

76. *Id.*

77. Pride Africa, *supra* note 63, at 4.

78. *Id.*

costs of multiple depositors.⁷⁹ In addition, the MFIs expertise in attracting microborrowers, identifying their needs, and managing unique relationships with them are strategic advantages that the bank would lack if it attempted to reach the clients itself.⁸⁰ In this way, the commercial bank can expand its reach to a lower income market without having to go through the growing pains and steep learning curves associated with market entry.

In addition, while smaller loans may be seen as riskier, there is an advantage to microbusiness. The decreased vulnerability of microbusinesses to stock market and other economic fluctuations compared to their larger counterparts could provide hedging potential for some types of risk. Evidence of the potential for this hedging phenomenon is provided by two recent examples in Indonesia and Bolivia. During the 1997 Indonesian financial crisis and the 2001-2003 Bolivian banking crisis, MFIs proved to be significantly less sensitive to the economies' fluctuations and their risk profiles remained significantly stable compared to those of commercial banks.⁸¹ During the Indonesian crisis, while commercial bank portfolios plummeted, repayment among the largest MFI in the country, Bank Rakyat Indonesia, hardly declined at all. During the Bolivian banking crisis, one telling measure of the significant difference in risk-sensitivity between commercial banks and MFIs was the average of Portfolios at Risk (PARs), namely loans overdue by more than thirty days. For commercial banks, the average PAR went from 6.5 percent in 1999 to an alarming 17.6 percent at the peak of the crisis in 2002. Meanwhile, the average PAR for MFIs in Bolivia only fluctuated between 6.2 percent at the beginning of the crisis and 9.1 percent at its peak, returning to 7.2 percent in 2002, more than ten percentage points below the average for the commercial banks that year.⁸² Finally, the bank could benefit from the higher interest income earned by MFI loans which, as discussed above, are sometimes twice that of the normal commercial bank APR.

One of the banks recognizing these potential benefits is Credit Suisse, which recently entered a partnership with a number of MFIs through the Responsibility Global Microfinance Fund.⁸³ The bank's main stated goal in the partnership is to provide assistance to MFIs and earn a high social return while earning an adequate financial return, Credit Suisse management also cites excellent repayment ratios and favorable interest rates as reasons why microfinancing partnerships are mutually beneficial.⁸⁴ The MFI data from Bolivia and Peru show strong evidence supporting this

79. *Id.* at 5.

80. *Id.* at 6.

81. Littlefield & Rosenberg, *supra* note 73, at 38.

82. *Id.*

83. Interview with Arthur Vayloyan, Head of Private Banking Switzerland, Microfinance: Minor Investments, Major Impact (Mar. 1, 2005), available at <http://emagazine.credit-suisse.com/article/index.cfm?fuseaction=OpenArticle&aoid=78717&lang=EN>.

84. *Id.*

perception.⁸⁵ For example, data from Bolivian MFIs rated by the agency MicroRate showed that, at the height of the Bolivian banking crisis in the average commercial sector return of equity (ROE) went from negative 8 percent in 1999 to negative 15 percent in 2000. Meanwhile the average ROE for the MFIs was stable during 1999 and 2000 at 7 percent.⁸⁶ A similar example occurred in Peru where in 2001 the rated MFIs far outpaced the commercial sector with an ROE of 28 percent compared to the commercial ROE of 4 percent.⁸⁷ These two examples show that, especially in times of financial crisis, MFIs are not only much more stable but also significantly more profitable in proportion to their capital investment. This is further evidence that commercial banks could approach MFI partnerships as a way to hedge against macroeconomic risks.

The partnerships, therefore, would not only present an opportunity for MFIs to stabilize, reach self-sufficiency, and grow their scope and profitability, but they would also give the commercial banks an opportunity to benefit from MFI's expertise in reaching a new, lower-income bracket and take advantage of the decreased sensitivity of MFIs to macroeconomic forces in order to hedge the risk of their commercial portfolios.

There are, however, some potential drawbacks to the prospect of partnerships between commercial banks and MFIs. One such drawback is that MFIs are often started and managed by NGOs that may be weary about partnering with a commercial bank, which they may perceive as not sharing their focus and approach to microlending. There is a long-standing divide in organizational cultures between NGO's approach to microfinancing and the business world that may lead some MFI managers to be reluctant to trust commercial bank managers with their clients.⁸⁸ A more concrete version of this problem could be that commercial banks, which traditionally focus more on profit and risk than microfinancing as development aid, may be reluctant to take on the poorest and riskiest clients or the smallest loans. That is, the microlending practices of MFIs will likely not fit the traditional parameters of commercial lending, and will have to be treated as a completely separate category subject to very different standards. But this potential drawback could be addressed by designing the partnership's parameters in a way that will allow the MFI to continue servicing its clients and using its risk and return models, while providing it with the economies of scale robustness of funding and risk management that the commercial banks possess. The partnership could,

85. Damian von Stauffenberg, *Trends in Latin American Microfinance*, MICROBANKING BULLETIN, Nov. 2002, at 19, 20, available at http://www.mixmbb.org/en/mbb_issues/08/Trends%20in%20LA%20Microfinance.PDF#search=%22%22Trends%20in%20Latin%20American%20Microfinance%22%22.

86. *Id.*

87. *Id.*

88. See generally Julia Verbrugge, *The Challenges of Managing Microfinance Projects in Latin America*, ITDG PUBLISHING (ALTERNATIVE FINANCE: MICROFINANCE ARTICLE LIBRARY) (June 2003); http://www.alternative-finance.org.uk/rtf/verbrugge_mfinlatam.rtf (last visited Sept. 11, 2006).

for example, give the MFI management authority over loan decisions while allowing the commercial bank to manage the deposit operations. These decisions could be subject to a number of pre-agreed standards that could be negotiated between the commercial bank and the MFI prior to the formation of the partnership. In exchange for the preservation of authority over lending, the commercial bank could be given authority over the management and investment of deposit funds. In addition the commercial bank could require its partner to contribute to the funding of risk-prevention measures such as loan insurance, which would likely be made affordable by the commercial bank's risk-hedging potential and the economies of scale that are common to the commercial bank's operations.

Another potential drawback of the partnerships is the unilateral risk assumption by banks that requires them to invest in partnering with MFIs without being able to internalize or profit from any of the positive social externalities associated with economic development. While MFIs may prove to be profitable investments once the partnership is stable, the initial investment will nonetheless be highly risky, judging from the fact that only about 1 percent of MFIs are currently sustainable.⁸⁹ Since partnerships between banks and MFIs are a relatively new concept, it will be difficult for banks to initially determine the risk involved in their venture. This is aggravated by the fact that in most countries there is little or no formal financial supervision of NGO-run MFIs since they do not have formal financial institution licenses. This also means that there are currently few official rating systems of efficiency and financial stability that would allow the bank to determine the risk involved with particular NGOs. The low predictability and high-risk characteristics of MFI investments may make them less attractive to banks and may prevent the public-private partnership movement from growing.

But there are several possible solutions to address this potential problem. First, the governments of countries where these partnerships are established could potentially introduce default protection or other insurance incentives that will mitigate the risk associated with MFIs. In addition, they can encourage the country's rating agencies to introduce specialized rating and measurement systems to evaluate the performance and risk of MFIs, and help commercial banks decide on which will be a better investment. Alternatively, the governments could directly contract out or subsidize the rating responsibilities to private rating organizations. There are already organizations that are dedicated to applying financial rating principles to MFIs. For example, MicroRate was the first rating company to focus exclusively on MFIs and rates approximately 200 MFIs in Africa and Latin America.⁹⁰ Their system does not employ solely traditional rating tools but rather assesses MFI risk using a tailored evalu-

89. INTERNATIONAL MONETARY FUND, *supra* note 2, at 7.

90. MicroRate, *The Company*, <http://www.microrate.com/ENGLISHsite/ABOUT/aboutf.htm> (last visited Sept. 9, 2005).

ation system that assesses the financial health of the MFI, its portfolio quality, information systems, and internal controls, by applying standards that reflect the unique context of the microlending practice.⁹¹ Commercial banks could require such rating analysis from potential MFI partners in order to better measure their risk. In addition, governments could subsidize this process to broaden the scope of rated MFIs. This would not only foster partnerships by making risk more manageable and measurable, but would also incentivize MFIs to improve their financial and management techniques in order to improve their ratings and increase their likelihood of commercial support. This potential is evidenced by the MicoRate example, which has found that rated MFIs showing progress through the evaluation process have found the process to be a strong incentive for attracting founders.⁹² This solution could thereby not only help create more stable and secure partnerships, but also raise the level of transparency, professionalism, and efficacy for the MFI industry in general.

It appears, therefore, that the most significant drawbacks associated with the partnership concept can be mitigated through effective partnership structuring and increased oversight of MFIs. When weighing these manageable concerns against the significant potential benefits of greater profitability, stability, and growth for MFIs, and market expansion and risk hedging for commercial banks, the risk utility analysis makes commercial-MFI partnerships an option with the potential for great success. The following section will address recommendations

V. CONCLUSION AND RECOMMENDATIONS

The stabilization and increased profitability of MFIs that can be achieved through commercial partnerships will allow the microfinancing industry to move into a new stage of significant growth and scope expansion that will likely make a significant impact in development finance. These partnerships seem to be the perfect way to combine the benefits of the unique expertise of specialized MFIs with the greater funding capabilities, structure, security, and technological advances of private industries. While MFIs and commercial banks will clearly be the leading actors in this effort, in order for it to be successful, governments, international development banks, and international organizations must cooperate with these primary actors to create economic incentives, financial assurances, technical assistance, and regulatory and legal tools that facilitate the implementation and management of such partnerships. In order to achieve this goal, there are a number of strategies that should be implemented by the government and international actors.

First, there must be an effort by the governments of developing countries to create a legal and regulatory environment that allows commercial

91. *Id.*

92. *Id.*

banks to enter into such partnerships. Several countries have already undertaken such initiatives. For example, in Pakistan the government introduced, in 2001, the Microfinance Sector Development Program, a package of legal reforms and initiatives designed, in part, to facilitate the regulation and development of commercial bank-MFI partnerships.⁹³ Such efforts are also being undertaken at the international level. For example, in 2004 the Group of Eight Countries announced an action plan to increase access to microfinance, which will focus on identifying the regulatory and legal barriers to the establishment of commercial bank-MFI partnerships and work on reforming the applicable laws to facilitate and encourage such initiatives.⁹⁴ Countries that wish to promote commercial bank-MFI partnerships should follow this model in identifying the tax, interest rate regulation, and financial regulation barriers to partnerships and in introducing regulatory reforms that will address the unique challenge of integrating the microlending practice into a commercial framework.

In addition, the international development banks and organizations, such as the World Bank, the Asian Development Bank, the InterAmerican Development Bank, the U.N. Capital Development Fund, and others, should make a concerted effort to offer commercial institutions, that are considering entering into such partnerships, extensive technical assistance and advice to help them choose the right MFI partners and partnership structures that allow both parties to derive the greatest benefit from the others' competitive advantage, while maintaining their unique strengths and mitigating risk. These organizations should invest in exploring the best contractual arrangements for such partnerships in order to provide potential partners with the best advice on the structure that best fits their particular context. These large organizations would be in the best position to provide such advice and guidance due to their extensive resources, relationships with the MFI world, and developed expertise on the special financial environments of different regions.

These groups could form partnerships with the leading microfinance NGOs such as ACCION and FINCA, which have already begun looking into private-public partnership alternatives, and work with them to develop best practices as well as pass along advice and information gained from their experiences to future partnerships. They can also work on actively creating partnership models that are tailored to specific regional needs by working with NGOs like Pride Africa that have developed region-specific partnership strategies. The international organizations may even sponsor pilot partnerships by providing financial backing and insurance for commercial financial institutions to explore different potential partnership structures in a control and risk-managed environment. These

93. *Developing Non Bankable Territories for Financial Services*, USAID Pakistan, Fourth Quarterly Report, Sept. 30, 2004.

94. News Release, The White House Office of the Press Secretary, G8 Action Plan on Poverty (June 9, 2004), <http://www.whitehouse.gov/news/releases/2004/06/20040609-35.html>.

pilot programs could then be phased into actual independent partnerships once they stabilize. This pilot project model would not only allow development organizations to explore the best ways to structure these partnerships, but would also allow commercial institutions to have a secure and gradual transition into the partnerships, which would likely increase confidence and buy-in from traditionally risk-adverse financial institutions.

Another initiative that the international organizations, governments, and NGOs could collaborate to promote these partnerships is by sponsoring or subsidizing a rating and assessment system that will measure the financial stability and success associated with particular MFIs in order to help commercial banks evaluate their potential partners. Such a rating system would also encourage greater transparency and efficiency among MFIs and would help them transition into the more organized and formal process associated with a private partnership. A rating system would ensure that MFIs constantly strive for more effective management and processes, which will in turn contribute to the success of the partnerships. The Inter-American Development bank has already invested in such a system in collaboration with the European Union called the Microfinance Rating and Assessment Fund (the Fund).⁹⁵ The Fund provides Credit Risk Ratings and Global Risk Assessments of MFIs, which focus both on default risks and on more subjective measures such as management quality and ability to meet contractual obligations.⁹⁶ The fund also focuses on tracking progress and increasing transparency.⁹⁷ The goal of the Fund is to increase MFI access to capital by providing commercial donors with reliable information to facilitate their investment choices.⁹⁸ The other development banks and international organizations should either continue to expand the scope of the Fund or use its efforts as a model by other international organizations to establish similar rating initiatives. Official rating systems focusing on microfinancing will provide a strong incentive to improve current MFIs and give commercial partners the tools they need to make informed decisions about their partnership choices.

By implementing regulatory incentives, providing technical assistance, and sponsoring rating systems to enable the establishment of commercial-MFI partnerships, governments and international organizations will help create an environment where commercial banks can best collaborate with MFIs to create sustainable and far-reaching microlending programs that could greatly increase capital access to the poor. Unlike the regulatory window approach, which could create damaging incentives for the proliferation of unstable and unsustainable MFIs, this approach will ensure that MFIs become reliable, formal institutions that can provide microlending services on a permanent basis. In this sense, the commer-

95. The Rating Fund, *About the Fund*, <http://www.ratingfund.org/content.aspx?cID=3> (last visited Sept. 9, 2005).

96. *Id.*

97. *Id.*

98. *Id.*

cial partnership approach is a much more conscientious, long-term answer to the need for greater funding sources for MFIs.

The increased profitability, stability, and growth potential that these partnerships will bring to MFIs will allow them to expand their scope and continue to foster economic growth in developing communities worldwide. In addition, the commercial partners of MFIs will be able to contribute to the development effort while reaching new markets and hedging their risk with microloan investments that are less sensitive to market changes and have shown substantial return on equity potential. This effort will, therefore, greatly benefit both MFIs and commercial banks in substantial ways. But perhaps the single most important benefit rising from this initiative will be the strengthening of the microfinancing industry as a stable, long-term approach to combating poverty.

